



GULF STATES UTILITIES COMPANY

RIVER BEND STATION POST OFFICE BOX 220 ST. FRANCISVILLE, LOUISIANA 70776
AREA CODE 504 635-6004 346-8651

November 22, 1989
RBG-31793
File Code G9.5

U.S. Nuclear Regulatory Commission
Document Control Desk
Washington, D.C. 20555

Gentlemen:

**River Bend Station Unit 1
Docket No. 50-458
Secondary Financial Protection**

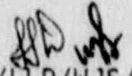
In a letter dated August 28, 1989, (RBG-31424) Gulf States Utilities Company (GSU) and Cajun Electric Power Cooperative, Inc. (Cajun) provided Certified Cash Flows as required by 10CFR140.21 and GSU's Annual Report. The Cajun Annual Financial Report was to be provided upon availability.

Since an annual financial report will not be compiled for 1988, attached is an independent auditor's report of Cajun Electric Power Cooperative, Inc. to complete that obligation.

Should you have any questions in this matter, please contact Mr. L. L. Dietrich of my staff at (504) 381-4866.

Sincerely,

J. E. Booker
Manager, River Bend Oversight
River Bend Nuclear Group


JEB/LAE/LLD/WJS/pg

cc: U. S. Nuclear Regulatory Commission
611 Ryan Plaza Drive, Suite 1000
Arlington, TX 76011

NRC Resident Inspector
P. O. Box 1051
St. Francisville, LA 70776

8912010048 891122
PDR ADOCK 05000458
I PDC

M004
11

Audited Financial Statements

Cajun Electric Power
Cooperative, Inc.

December 31, 1988

EW Ernst & Whinney

AUDITED FINANCIAL STATEMENTS

CAJUN ELECTRIC POWER COOPERATIVE, INC.

DECEMBER 31, 1988

REPORT OF INDEPENDENT AUDITORS	1
BALANCE SHEETS	3
STATEMENTS OF REVENUE AND EXPENSES	5
STATEMENTS OF CHANGES IN EQUITY AND MARGIN (DEFICIT)	6
STATEMENTS OF CASH FLOWS	7
NOTES TO FINANCIAL STATEMENTS:	
NOTE A - COMMITMENTS AND CONTINGENCIES	8
NOTE B - SIGNIFICANT ACCOUNTING POLICIES	12
NOTE C - UTILITY PLANT	14
NOTE D - INVESTMENTS IN ASSOCIATED ORGANIZATIONS	16
NOTE E - DEFERRED CHARGES	17
NOTE F - FEDERALLY GUARANTEED LONG-TERM DEBT SUBJECT TO ACCELERATION, LONG-TERM DEBT SUBJECT TO ACCELERATION AND LONG-TERM DEBT	17
NOTE G - NOTES PAYABLE AND AMOUNTS DUE GUARANTOR	22
NOTE H - SHORT TERM INVESTMENTS	23
NOTE I - INCOME TAXES	23
NOTE J - EMPLOYEE BENEFIT PLAN	25
NOTE K - RELATED PARTY TRANSACTIONS	25
NOTE L - SPENT NUCLEAR FUEL AND DECOMMISSIONING COSTS	25
NOTE M - NUCLEAR INSURANCE	26
NOTE N - EXTRAORDINARY ITEM	27
NOTE O - GULF STATES UTILITIES COMPANY	28
NOTE P - RATES AND REGULATION	29
NOTE Q - SUBSEQUENT EVENTS	30

REPORT OF INDEPENDENT AUDITORS

Board of Directors
Cajun Electric Power Cooperative, Inc.
Baton Rouge, Louisiana

We have audited the accompanying balance sheets of Cajun Electric Power Cooperative, Inc. (the Cooperative) as of December 31, 1988 and 1987, and the related statements of revenue and expenses, changes in equity and margin (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Our report, dated March 4, 1988, on the 1987 financial statements was qualified in that the Cooperative had not classified its long-term debt in default as a current liability and did not expense approximately \$25 million related to excess coal costs. The Cooperative has restated its 1987 financial statements to properly classify such long-term debt in default as a current liability and, accordingly, our present opinion on the 1987 financial statement is no longer qualified with respect to such classification.

In our opinion, except for the effects on the 1987 financial statements of the matter discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Cajun Electric Power Cooperative, Inc. at December 31, 1988 and 1987, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming the Cooperative will continue as a going concern. As described in Note A, the Cooperative has determined that due to present economic and market conditions and costs related to its investment in the River Bend nuclear generating facility, it will not be able to increase its wholesale power rates to a level necessary to recover the recorded costs of its utility plant nor to liquidate its liabilities in the ordinary course of business. The Cooperative sustained net deficits for the years ended December 31, 1988 and 1987, and was unable to meet certain mortgage covenants and to pay all of its scheduled interest payments on certain of its notes when due;

these events of default placed substantially all of the Cooperative's long-term indebtedness in default under cross default provisions contained in the debt instruments. The Cooperative is negotiating with the United States Department of Agriculture Rural Electrification Administration (REA), its major creditor as guarantor of substantially all of its long-term debt, and with other significant creditors, to substantially restructure its debt agreements to defer and reduce its debt service requirements to a level which will provide for recovery of its recorded assets and liquidation of its liabilities in the ordinary course of business. The Cooperative is presently unable to determine the outcome of the restructuring. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary in order for the Cooperative to continue as a going concern. Realization of its assets and payment of its liabilities are dependent upon the Cooperative's ability to successfully obtain the necessary restructuring of its debt agreements and the improvement of its operating results.

As discussed in Notes A and Q, Citibank, N.A. has filed suit in a United States district court in New York against the Cooperative seeking payment of approximately \$206 million on certain demand notes, interest and other charges owed by the Cooperative. Management is unable to determine the outcome of present negotiations with Citibank, N.A.

As discussed in Notes A and O to the financial statements, the ability of Gulf States Utilities Company (GSU) to continue making payments to the Cooperative under an agreement for the output of the nuclear generating facility is uncertain. Also, GSU has asserted significant claims against the Cooperative for certain transmission charges. The Cooperative disputes these claims and is involved in proceedings with the Federal Energy Regulatory Commission to resolve this matter. Further, as discussed in Notes A and Q, the ultimate outcome of the bankruptcy proceedings of one of the Cooperative's members as to the collection of amounts receivable from the member of approximately \$23 million and the rejection of the existing contract for the supply of power by such member, which is being litigated, are uncertain; the ultimate effects of regulation by the Louisiana Public Service Commission and the ultimate resolution of certain litigation cannot be presently determined. Failure of the Cooperative to satisfactorily resolve these uncertainties could have a material effect on its financial position and could further impair the Cooperative's ability to continue as a going concern.

Ernst & Whinney

March 10, 1989, except as to the
third paragraph of Note Q, the
date of which is March 20, 1989.

	December 31	
	<u>1988</u>	<u>1987</u>
EQUITY AND LIABILITIES		
EQUITY AND MARGIN (DEFICIT)		
Memberships	\$ 1	\$ 1
Patronage capital credits	36,533	36,533
Unallocated deficit	(535,333)	(66,402)
Donated capital	406	406
	<u>(498,393)</u>	<u>(29,462)</u>
LONG-TERM DEBT		
less scheduled maturities	11,567	20,965
CURRENT LIABILITIES		
Federally guaranteed long-term debt subject to acceleration	2,645,314	2,875,144
Long-term debt subject to acceleration	77,904	91,217
Notes payable and amounts due guarantor	312,527	
Accounts payable	263	2,105
Accrued interest and other expenses	113,401	78,742
Scheduled maturities of long-term debt	11,066	3,101
	<u>3,160,475</u>	<u>3,050,309</u>
DEFERRED CREDITS	5,466	8,790
COMMITMENTS AND CONTINGENCIES		
	<u>\$2,679,115</u>	<u>\$3,050,602</u>

See notes to financial statements.

STATEMENTS OF REVENUE AND EXPENSES
CAJUN ELECTRIC POWER COOPERATIVE, INC.

(In Thousands)

	Year Ended December 31	
	1988	1987
OPERATING REVENUE		
Sales of electric energy:		
Members	\$ 269,779	\$ 293,538
Nonmembers	177,389	217,696
Other	996	643
	<u>448,164</u>	<u>\$11,877</u>
OPERATING EXPENSES		
Power production:		
Fuel	148,688	121,378
Operations and maintenance	63,736	64,029
Purchased power	4,356	10,181
Other power supply expenses	645	758
Transmission	32,126	24,934
Administrative and general	14,522	15,472
Depreciation and amortization	78,253	89,692
Taxes, other than income	2,353	2,460
	<u>344,679</u>	<u>328,904</u>
OPERATING MARGIN	103,485	182,973
OTHER INCOME AND EXPENSES		
Interest, rents and leases	7,342	5,626
Other income	1,061	2,893
Allowance for funds used during construction	1,138	1,218
Amortization of deferred charges	(10,263)	(12,945)
	<u>(722)</u>	<u>(3,208)</u>
MARGIN BEFORE INTEREST AND OTHER DEBT EXPENSE AND EXTRAORDINARY ITEM	102,763	179,765
INTEREST AND OTHER DEBT EXPENSE	<u>250,856</u>	<u>246,167</u>
DEFICIT BEFORE EXTRAORDINARY ITEM	(148,093)	(66,402)
EXTRAORDINARY ITEM	<u>(320,838)</u>	<u>—</u>
NET DEFICIT	<u>\$ (468,931)</u>	<u>\$ (66,402)</u>

See notes to financial statements.

STATEMENTS OF CHANGES IN EQUITY AND MARGIN (DEFICIT)

CAJUN ELECTRIC POWER COOPERATIVE, INC.

(In Thousands)

Years Ended December 31, 1988 and 1987

	<u>Member- ships</u>	<u>Patronage Capital Credits</u>	<u>Unallocated Deficit</u>	<u>Donated Capital</u>	<u>Total</u>
BALANCE JANUARY 1, 1987	\$1	\$36,533		\$406	\$ 36,940
Net deficit for the year			\$ (66,402)		(66,402)
BALANCE DECEMBER 31, 1987	<u>1</u>	<u>36,533</u>	<u>(66,402)</u>	<u>406</u>	<u>(29,462)</u>
Net deficit for the year			<u>(468,931)</u>		<u>(468,931)</u>
BALANCE DECEMBER 31, 1988	<u>\$1</u>	<u>\$36,533</u>	<u>\$(535,333)</u>	<u>\$406</u>	<u>\$(498,393)</u>

See notes to financial statements.

STATEMENTS OF CASH FLOWS
CAJUN ELECTRIC POWER COOPERATIVE, INC.

(In Thousands)

	Year Ended December 31	
	1988	1987
OPERATING ACTIVITIES		
Net deficit	\$(468,931)	\$(66,402)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	71,455	84,050
Amortization of nuclear fuel	19,719	15,456
Amortization of deferred charges and credits - net	15,845	10,195
(Increase) in accounts receivable and other accrued revenue	(3,963)	(34,386)
(Increase) in fuel and supplies inventories	(5,145)	(3,216)
(Increase) decrease in prepayments	659	(166)
(Decrease) in accounts payable	(1,842)	(1,109)
Increase in accrued interest and other expenses	40,186	45,885
Extraordinary item less current payments	298,305	
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	(33,712)	50,307
INVESTING ACTIVITIES		
(Increase) in utility plant	(24,042)	(25,094)
(Increase) decrease in investments	4,758	(6,503)
Decrease in restricted funds held by trustee	27,618	265
(Increase) in deferred charges	(6,724)	(4,524)
Increase in deferred credits	5,753	4,300
NET CASH PROVIDED (USED) IN INVESTING ACTIVITIES	7,363	(31,556)
FINANCING ACTIVITIES		
Proceeds from issuance of long-term debt	1,045,350	1,000
Proceeds from issuance of demand notes payable and payments by guarantor	326,887	
Repayment of long-term debt, federally guaranteed long-term debt subject to acceleration and long-term debt subject to acceleration	(1,309,813)	(23,269)
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	62,424	(22,269)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	36,075	(3,518)
Cash and cash equivalents at beginning of year	52,071	55,589
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 88,146	\$ 52,071

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

CAJUN ELECTRIC POWER COOPERATIVE, INC.

December 31, 1988

NOTE A - COMMITMENTS AND CONTINGENCIES

Workout/Debt Restructure: During 1988, Cajun Electric Power Cooperative, Inc. (the Cooperative) was unable to make full payment on all debt service obligations as they became due and, as of December 31, 1988, cumulative arrearages totalled \$149.8 million. In addition, the Cooperative did not pay certain demand notes of approximately \$200 million held by an unsecured creditor (see Notes G and Q). Through cross default provisions of various debt agreements, an event of default exists on substantially all of the Cooperative's debt. As of December 31, 1988, no creditors, other than the unsecured creditor mentioned above, have accelerated the Cooperative's debt (see Notes F and Q).

As of December 31, 1988, the Cooperative was operating under payment restrictions set forth by the United States Department of Justice (DOJ), representing the U.S. Department of Agriculture, Rural Electrification Administration (REA). The DOJ stated in a letter dated September 16, 1988, that the DOJ, on behalf of the REA, would not bring suit against the Cooperative's officers, directors, and manager with respect to funds used to pay reasonable operating expenses and certain other costs necessary for the continued reliable operation of the Cooperative (the 3713 Waiver). The 3713 Waiver relates to Section 3713 of Title 31 of the U.S. Code and, in the Cooperative's case, is effective for a period of ninety days; however, the DOJ reserved the right to revoke or modify any provision of its action on seven days written notice to the Cooperative. The first 3713 Waiver was issued by the DOJ on December 14, 1987, and the DOJ provided the Cooperative a 3713 Waiver approximately every 90 days during 1988. On December 8, 1988, the Cooperative received a 3713 Waiver effective for the first quarter of 1989 (see Note Q). In the event of the DOJ's revocation of the 3713 Waiver, the Cooperative may seek protection from its creditors under Chapter 11 of the Bankruptcy Code. The Cooperative believed it was in compliance with the provisions of the 3713 Waiver during 1988, and has engaged special counsel to assist in workout/debt restructure negotiations and bankruptcy matters.

NOTE A - Continued

The Cooperative anticipates that the DOJ will continue to provide a 3713 Waiver each ninety days as it has done throughout the past year. The 3713 Waiver has allowed the Cooperative to pay certain indebtedness related to River Bend Unit 1 (River Bend) and the Cooperative's headquarters building but it does not provide protection from legal action by the DOJ with respect to payments made by the Cooperative on certain unsecured debt; accordingly, during 1988 the Cooperative, acting on the advice of counsel, ceased making payments with respect to debt service and fees on pollution control revenue bonds (see Notes G and Q).

On July 10, 1987, the Cooperative filed a workout/debt restructure plan with the REA. The Cooperative's plan involves several proposed actions by the Cooperative, its suppliers and creditors, and its Members and is designed to achieve reliable, competitively priced electricity for rural Louisiana. The workout/debt restructure plan proposed by the Cooperative included the following major provisions: a) a reduction of wholesale rates charged to Members and the indexing of future rate increases; b) the restructuring of debt service obligations to coincide with projected cash flows; c) access to low interest rate substitute loans (or REA equivalent relief) to reduce future interest costs; d) continued negotiations with suppliers to reduce future operating costs; e) the selling of existing assets, when and if appropriate; f) the return of any excess cash to the REA and g) the implementation of appropriate accounting changes.

During 1988, the Cooperative met on several occasions with all major creditors to negotiate a debt restructure and efforts were continuing as of December 31, 1988. At the request of the REA, on November 15, 1988, the Cooperative delivered to the REA a comprehensive draft term sheet setting forth more detail and certain changes to the plan filed on July 10, 1987. The REA indicated it would be unable to respond by year-end to the comprehensive term sheet so, on December 2, 1988, the Cooperative proposed an interim Implementation Agreement to be executed by the REA, Jackson Bank for Cooperatives (JBC) and the Cooperative. The purpose of the Implementation Agreement was to set forth certain understandings and agreements regarding the basis upon which the workout/debt restructure of the Cooperative would proceed. The REA and JBC declined to execute the Implementation Agreement. On December 22, 1988, the Cooperative submitted a proposed Fuel Cost Phase-In Program to the REA in an attempt to remove any uncertainty about the Cooperative's ability to maintain stable rates for 1989. As of year-end, none of these proposals had been approved. As of December 31, 1988, these creditors had not presented a counterproposal to the plans proposed by the Cooperative nor had they instituted legal action against the Cooperative and all parties were continuing to negotiate. During 1988, the REA approved a special credit to the fuel cost adjustment which allowed a rate

NOTE A - Continued

reduction for the Cooperative's Members and also approved new rate schedules promoting special incentives and economic development (see Note P).

The Cooperative has based its workout/debt restructure plan negotiations on the belief that all parties (secured and unsecured creditors, suppliers, regulators, the Cooperative and its Members) are better served if the Cooperative remains a reliable producer of competitively priced wholesale electricity for the long-term. The Cooperative cannot predict the outcome of the workout/debt restructure negotiations currently underway (see Note Q).

Washington-St. Tammany Electric Cooperative, Inc.: On July 17, 1987, one of the Cooperative's Members, Washington-St. Tammany Electric Cooperative, Inc. (WST), sought protection from its creditors under Chapter 11 of the U.S. Bankruptcy Code. At the time of filing, WST owed the Cooperative \$6.7 million in pre-petition power bills. WST is continuing payments for power, but at amounts below the billed rate. The Cooperative has deemed it prudent to continue to supply power to WST.

On March 8, 1988, WST filed a motion in bankruptcy court to reject the existing contract with the Cooperative for the supply of power. Post-petition unpaid power bills as of December 31, 1988 (including interest) amounted to \$16.5 million. The total amount receivable from WST (including interest) aggregated \$23 million at December 31, 1988, of which approximately \$21.6 million is included in other receivables. The Cooperative is the single largest unsecured creditor in the WST bankruptcy proceeding. Recovery of amounts owed to the Cooperative for power supplied to WST cannot be predicted with certainty (see Note Q).

Gulf States Utilities Company: As discussed more fully in Note O, Gulf States Utilities Company (GSU) will owe the Cooperative approximately \$171 million over the remaining two and one-half years of the Sell-back Agreement which is related to the Joint Ownership Participation and Operating Agreement for River Bend. This Sell-back Agreement has the effect of mitigating the cost and rate impact of the Cooperative's \$1.5 billion investment for its 30% share of River Bend. Should these revenues not be received from GSU in the amounts and in accordance with the schedule contractually agreed to, the Cooperative could be further impaired in its ability to meet its obligations (see Note O).

The Cooperative and GSU are parties to a Federal Energy Regulatory Commission (FERC) proceeding regarding certain transmission service charges. At December 31, 1988, GSU alleged that the Cooperative had underpaid transmission charges in the amount of approximately \$43.6

NOTE A - Continued

million. The Cooperative disputes the GSU assertion. Proceedings at the FERC are continuing. The timing and outcome of this matter cannot be predicted with certainty.

Coal and Transportation Commitments: Purchases under the terms of contracts for the acquisition of coal and related transportation contracts during 1988 and 1987 were approximately \$120 million and \$114 million, respectively. Certain contract purchases are subject to various price escalators and deflators, to minimum quantity takes and to periodic price reopeners at then current market prices. Management is of the opinion that these coal contracts will properly meet anticipated fuel needs. The transportation contracts begin to expire in 1999 while the coal contracts are for the useful lives of the coal units (see Note C).

Litigation: In August 1988, a federal district court jury in Baton Rouge ruled the Cooperative must pay \$25.3 million in compensatory damages plus compounded interest at 12% in litigation related to abandoned lignite projects. In November 1988, the Cooperative petitioned the court requesting the jury verdict be set aside and a new trial be granted. As of December 31, 1988, the judge had not affirmed the jury's decision. The Cooperative is also involved in an arbitration hearing with a claim concerning construction issues associated with its Big Cajun II, Units 1 and 2 coal-fired generating facility. The results of these hearings and lawsuits cannot be predicted with certainty and the final judgments could be significant and material to the Cooperative (see Notes G and Q).

Loan Commitments: As of December 31, 1988, the Cooperative had unadvanced loan commitments from the Federal Financing Bank (FFB) (subject to the control and guarantee of the REA) totalling approximately \$90 million. The Cooperative does not expect to be able to access these commitments until the workout/debt restructure negotiations have been completed. At December 31, 1988, the Cooperative had other loan commitments (the FFB set-asides) subject to the control and guarantee of the REA amounting to approximately \$106 million related to previously outstanding pollution control revenue bonds and the Citibank, N.A. demand notes. During 1988, the REA denied a requisition by the Cooperative for set-aside funds and therefore, the ability of the Cooperative to draw down future funds under the FFB set-asides is uncertain. The Cooperative's lines of credit with National Rural Utilities Cooperative Finance Corporation (CFC) and JBC expired in February and March of 1988, respectively. The JBC declined to renew the Cooperative's line of credit until the workout negotiations are completed, while CFC agreed to consider the extension of a line of credit provided certain conditions were met. At December 31, 1988, the Cooperative had no lines of credit available and, because of the above uncertainties,

NOTE A - Continued

the Cooperative has established cash on hand above levels normally required for day-to-day operations (see Note F).

Environmental Closure Fund: The Cooperative is required by the State of Louisiana Department of Environmental Quality (DEQ) to provide assurance that it has the ability to fund the actions which will be necessary to secure and refurbish its Big Cajun II fly ash pond areas which, as disposal sites, are subject to DEQ review and supervision. Prior to 1987, the Cooperative had provided a letter of financial assurance to the DEQ stating that the Cooperative for the year in question had a net worth of at least \$10 million. As a result of the net deficits for 1987 and 1988 and their impact upon the equity position of the Cooperative, this form of assurance can no longer be provided. The total estimated liability for funding the solid waste disposal site rehabilitation is currently estimated to be approximately \$4 million (1987 dollars), of which GSU is responsible for approximately \$500,000. The actual payments for site rehabilitation are not scheduled to occur until the end of the estimated useful life of the Big Cajun II coal-fired facility (see Note Q).

NOTE B - SIGNIFICANT ACCOUNTING POLICIES

General: The Cooperative is a rural electric generation and transmission cooperative owned by 13 distribution cooperatives (Members) which provide electricity to approximately 300,000 metered customers representing over 1,000,000 people residing throughout 80% of the land area of Louisiana. The Cooperative and its 13 Members have entered into wholesale power contracts which require the Members to purchase all of their electric energy requirements from the Cooperative through the year 2021. The Cooperative is subject to certain rules and regulations promulgated for rural electric borrowers by the REA.

System of Accounts: The Cooperative maintains its accounting records in accordance with the FERC's chart of accounts as modified and adopted by the REA.

Electric Plant-in-Service: Electric plant-in-service is stated on the basis of cost. Depreciation is computed using the straight-line method over the expected useful lives of the related component assets. The cost of units of property replaced or retired, including costs of removal net of any salvage value, is charged to accumulated depreciation.

NOTE B - Continued

Nuclear Fuel: The cost of nuclear fuel, including interest on borrowed funds and allowance for funds used during construction (AFUDC), is being amortized to fuel expense on the basis of the actual number of units of thermal energy produced, multiplied by a unit cost which reflects the total thermal units expected to be produced over the life of the fuel (see Note L).

Construction-in-Progress: Construction-in-progress is stated on the basis of cost, which includes interest on borrowed funds and AFUDC, adjusted for costs allocable to joint participation agreements.

Investments: The terms of financing arrangements with the CFC and the JBC require investment in capital term certificates and Class "C" stock, respectively. These investments are carried at cost in the accompanying financial statements together with undistributed patronage capital credits from these organizations (see Note A). The Cooperative allocates patronage capital credits received from associated organizations to assets and expenses in the same ratio as the interest paid to these organizations is capitalized and expensed (see Note Q).

Fuel and Supplies Inventories: Fuel and supplies inventories are stated on the basis of cost utilizing the weighted average cost method of inventory valuation.

Deferred Charges and Credits: Prior to the discontinuation of SFAS No. 71 (see Note N), deferred charges consisted primarily of certain costs associated with an abandoned lignite project, the costs of development and operation of electrical generating facilities (including costs associated with common facilities and stockpiling fuel inventory) prior to commercial operation status and/or thereafter, but before the facilities achieved full capacity and certain costs associated with an amendment to the River Bend Sell-back Agreement (see Note O). These costs, with the exception of costs associated with stockpiling fuel inventory, were being amortized over periods prescribed by the Cooperative's Board of Directors and by the REA which did not exceed 15 years (see Note E). Deferred credits at December 31, 1988 consisted primarily of insurance claims and liability for environmental closure funds (see Note A).

Income Taxes: Certain revenue and expense items are recognized in different periods for financial reporting and income tax purposes thus creating timing differences. Deferred income taxes are provided on these timing differences which are principally related to depreciation on electric plant-in-service, income and deductions related to the additions to and amortization of deferred charges and credits, and the sale of tax benefits. The Cooperative uses the flow-through method of recognizing investment tax credits.

NOTE B - Continued

Patronage Capital Credits: The Cooperative is organized and operates on a not-for-profit basis. Patronage capital credits represent that portion of the Cooperative's net margins which have been allocated to Member cooperatives. As provided in the Cooperative's bylaws, all amounts received from the furnishing of electric energy in excess of the sum of operating costs and expenses and amounts required to offset any current year losses are assigned to Members' patronage capital credit accounts on a patronage basis or, at the discretion of the Board of Directors, may be offset against losses of any prior fiscal year. All other amounts received from operations in excess of costs and expenses may be used to offset losses incurred during the current or any prior fiscal year and to the extent not needed therefore, are allocated to Members on a patronage basis. In accordance with the Cooperative's bylaws, the 1987 and 1988 net deficits have not been allocated to the Member cooperatives.

Cash Equivalents: The Cooperative considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Reclassifications: Certain reclassifications have been made to the 1987 financial statements to conform to the 1988 presentation.

NOTE C - UTILITY PLANT

Electric plant-in-service at December 31 consisted of the following (in thousands) (see Note N):

	<u>1988</u>	<u>1987</u>
Production:		
Nuclear	\$1,468,357	\$1,465,891
Coal	1,021,972	1,080,915
Gas	32,169	31,781
Transmission	85,531	89,510
General	12,001	10,621
	<u>\$2,620,030</u>	<u>\$2,678,718</u>

<u>Generating Unit</u>	<u>Net Megawatt Rating</u>	<u>Fuel</u>	<u>Cooperative Ownership Share</u>	<u>Megawatt Share</u>
River Bend	936	Nuclear	30%	281
Big Cajun II, Unit 1	540	Coal	100%	540
Big Cajun II, Unit 2	540	Coal	100%	540
Big Cajun II, Unit 3	540	Coal	58%	313
Big Cajun I, Unit 1	105	Natural Gas	100%	105
Big Cajun I, Unit 2	105	Natural Gas	100%	105

NOTE C - Continued

River Bend and Big Cajun II, Unit 3 are jointly owned by the Cooperative and GSU (see Note O). In November 1988, the Cooperative received REA approval to prospectively change the estimated useful life of River Bend from 32 to 40 years effective January 1, 1988. Coincident with the change in the depreciation rate from 3.125% to 2.481%, annual depreciation expense will be reduced by approximately \$9.1 million.

Construction-in-progress consists of general additions to existing plants and certain costs related to recovery of claims arising out of the construction of Big Cajun II, Units 1 and 2 (see Note Q). The estimated cost to complete these projects at December 31, 1988 was approximately \$15.8 million.

Nuclear fuel represents the Cooperative's 30% share of River Bend fuel and at December 31 consisted of the following (in thousands):

	<u>1988</u>	<u>1987</u>
Nuclear fuel in process	\$ 51,595	\$ 41,359
Nuclear fuel in reactor	63,567	63,541
Spent nuclear fuel	<u>5,257</u>	<u>5,257</u>
	120,419	110,157
Less nuclear fuel amortization	<u>(45,441)</u>	<u>(25,721)</u>
Net nuclear fuel	<u>\$ 74,978</u>	<u>\$ 84,436</u>

Nuclear fuel in process represents the accumulated cost, including interest and AFUDC, of fuel required for the second reload, the third fuel reload and a portion of the fourth reload. The fuel is in varying stages of conversion, enrichment or fabrication. Nuclear fuel in the reactor was initially loaded in February 1985 and is being amortized to fuel expense. It will be replaced over three operating cycles covering approximately five years. The first operating cycle was completed in late 1987 and in December 1987, the first replacement of nuclear fuel (totalling approximately one-third of the initial core) was completed. The second replacement of nuclear fuel (totalling approximately one-third of the initial fuel load) is scheduled to begin in March 1989. Spent nuclear fuel consists of the original cost of nuclear fuel assemblies, in the process of cooling, transferred from nuclear fuel in the reactor during the first reload.

On March 18, 1988, the Cooperative and Sam Rayburn G&T Cooperative, Inc. (SRG&T) entered into a joint ownership participation and operating agreement enabling SRG&T to acquire a 7% undivided ownership interest in Big Cajun II, Unit 1. The agreement must be approved by the REA and must be closed prior to June 1, 1990. SRG&T is currently litigating certain issues with GSU. The Cooperative cannot predict the timing or the outcome of the SRG&T actions against GSU and, consequently, cannot predict whether REA will approve this transaction.

NOTE C - Continued

Land relating to an abandoned lignite project has been retained as a possible site for a future generating facility and its cost, \$9.8 million, is included in electric plant held for future use.

The net change in accumulated depreciation and amortization for the years ended December 31 was as follows (in thousands):

	<u>1988</u>	<u>1987</u>
Charged to operating expenses	\$71,455	\$84,050
Charged to fuel inventories	1,073	1,215
Extraordinary item	<u>(13,267)</u>	<u>85,265</u>
Less asset disposals	59,261	(1,218)
	<u>(598)</u>	<u>(1,218)</u>
	<u>\$58,663</u>	<u>\$84,047</u>

NOTE D - INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations at December 31 consisted of the following (in thousands):

	<u>1988</u>	<u>1987</u>
CFC	\$ 8,963	\$ 9,528
JBC	66,062	67,277
Other	<u>421</u>	<u>371</u>
	<u>\$75,446</u>	<u>\$77,176</u>

The Cooperative's investment in the JBC is pledged to secure certain borrowings from that organization (see Notes A and F).

NOTE E - DEFERRED CHARGES

Deferred charges at December 31, net of accumulated amortization, consisted of the following (in thousands) (see Note N):

	<u>1988</u>	<u>1987</u>
Abandoned project costs		\$ 73,037
Interest on excess coal		83,760
Charges for nondelivery of coal		68,668
Work orders	\$ 507	2,492
Losses resulting from the decrease in Btu content of stockpiled coal		12,561
Amendment to the River Bend Sell-back Agreement		10,997
Depreciation and interest on common facilities at Big Cajun II allocable to Unit 3		9,506
Solid waste closure fund	3,476	3,584
Other	6,287	9,997
	<u>\$10,270</u>	<u>\$274,602</u>

NOTE F - FEDERALLY GUARANTEED LONG-TERM DEBT SUBJECT TO ACCELERATION, LONG-TERM DEBT SUBJECT TO ACCELERATION AND LONG-TERM DEBT

Substantially all of the Cooperative's long-term debt is guaranteed by the REA which has the mortgage rights of noteholders whose notes have been guaranteed. As of December 31, 1988, the Cooperative was in arrears on scheduled debt service payments, and the REA, as guarantor, had paid on behalf of the Cooperative approximately \$124.6 million to the FFB, the Cooperative Utility Trusts and the JBC. Thus, as of December 31, 1988, all guaranteed noteholders were made current. However, as a result of the Cooperative's inability to make all payments on long-term debt when due and, through the cross-default provisions of various loan agreements and its mortgage, an event of default exists on substantially all of the Cooperative's long-term debt which is therefore subject to acceleration of scheduled maturities by creditors and is hereafter referred to as federally guaranteed long-term debt subject to acceleration and long-term debt subject to acceleration. As of December 31, 1988, no secured creditor had commenced any material action related to mortgage rights or remedies against the Cooperative (see Notes A and Q).

NOTE F - Continued

In accordance with generally accepted accounting principles (GAAP), the Cooperative has reclassified all long-term debt subject to acceleration as a current liability (see Notes A and Q). Federally guaranteed long-term debt subject to acceleration, long-term debt subject to acceleration and long-term debt at December 31 consisted of the following (in thousands):

	<u>1988</u>	<u>1987</u>
<u>Federally guaranteed long-term debt subject to acceleration</u>		
Guaranteed notes payable to the FFB, interest at 6.7% to 10.4% due in quarterly installments through December 2021.	\$1,052,799	\$2,107,444
Guaranteed notes payable to the JBC, interest at varying rates (7.8% to 9.6% at December 31, 1988), due in quarterly installments through December 2016.	551,881	560,050
Pollution Control Revenue Bonds, Series 1984, interest at varying rates based on a nationally recognized index of comparable tax-exempt bond issues (see Notes A, G and Q).		207,650
Guaranteed notes payable to the Cooperative Utility Trusts (see below).	1,040,634	
Federally guaranteed long-term debt subject to acceleration	<u>\$2,645,314</u>	<u>\$2,875,144</u>

Notes to Financial Statements - Continued
Cajun Electric Power Cooperative, Inc.

NOTE F - Continued

	<u>1988</u>	<u>1987</u>
<u>Long-term debt subject to acceleration</u>		
Mortgage notes payable to the REA, interest at 2% to 5% due in quarterly installments through June 2016.	\$39,143	\$41,258
Mortgage notes payable to the IBC, interest at varying rates (8.1% to 8.2% at December 31, 1988), due in quarterly installments through September 1998.	34,711	45,459
Industrial Development Revenue Bonds, Series 1982, interest at two-thirds of prime rate (7.04% at December 31, 1988), due in 9 annual installments from 1989 through 1997.	4,050	4,500
Long-term debt subject to acceleration	<u>\$77,904</u>	<u>\$91,217</u>
<u>Long-term debt</u>		
River Bend construction commitments, interest at 1% to 3% below prime rate (10.50% at December 31, 1988), \$4,831,000 due in January 1989 with the remainder due in monthly installments of \$600,000 (including interest).	\$22,633	\$24,066
Less scheduled maturities	<u>(11,066)</u>	<u>(3,101)</u>
Long-term debt	<u>\$11,567</u>	<u>\$20,965</u>

There are two types of notes payable to the FFB. The first type can have, at the option of the Cooperative, short-term maturity periods of 2 to 7 years during the first 7 years an advance is outstanding, unless the Cooperative elects a long-term maturity, in which case the maturity date would be 34 years after the end of the calendar year in which the advance was made. Principal repayment is generally deferred for 7 years. The second type of note can have, at the option of the Cooperative, recurring short-term maturity periods of 2 years during the term of the note, unless the Cooperative elects a long-term maturity, in which case the maturity date would be a maximum of 34 years from the end of the calendar year in which the note was issued. Principal amortization

NOTE F - Continued

on the second type of note is related to the projected commercial operation date of the project as provided by the REA.

On February 25, 1988, the Cooperative executed final documents on the refinancing of its highest cost FFB debt (average coupon rate of 10.82%) whereby the JBC loaned the Cooperative \$1.045 billion at a variable rate which was used to prepay an equal principal amount of FFB loans. The Cooperative issued thirteen notes in an aggregate amount equal to the amount of the loan from the JBC, each guaranteed by the REA, to thirteen separate Cooperative Utility Trusts. Each trust issued to the JBC certificates representing the entire beneficial interest in the trust (CBIs). On March 24, 1988, \$500 million of CBIs were sold in the public capital markets calling for semi-annual interest payments and annual principal payments with final maturities and coupons as follows:

\$ 21,896,000	at 8.08% due March 15, 1993
\$ 37,750,000	at 8.93% due March 15, 1998
\$440,354,000	at 9.52% due March 15, 2019

On May 16, 1988, \$200 million of CBIs were sold in the public capital markets calling for semi-annual interest payments and annual principal payments with final maturities and coupons as follows:

\$ 8,759,000	at 8.85% due March 15, 1993
\$ 15,101,000	at 9.65% due March 15, 1998
\$176,140,000	at 10.125% due March 15, 2019

The proceeds of the public offerings were used to repay the JBC and caused the interest rates to be fixed for the remaining life of the CBIs. The remainder of the CBIs at December 31, 1988, totalling approximately \$340.6 million, bear interest on a variable rate basis (averaging 9.53%) which is determined by the Cooperative and the JBC. It is the intent of the Cooperative that these CBIs will be the subject of a public offering upon improvement of interest rates in the long-term bond market. The interest rates of the CBIs determine the interest rates of the Cooperative's guaranteed notes payable to the Cooperative Utility Trusts.

At December 31, 1988, the Cooperative had exclusive right to decide when to sell the remaining \$340.6 million of CBIs in the public capital markets; however, the documents allow the JBC to cause a public offering should interest rates move above a benchmark rate.

NOTE F - Continued

Scheduled maturities of long-term debt at December 31, 1988 are shown below (in thousands):

	<u>Long-term Debt</u>
1989	\$ 11,066
1990	6,694
1991	4,873
	<u>\$ 22,633</u>

Interest and other debt expense incurred on long-term debt, federally guaranteed long-term debt subject to acceleration, long-term debt subject to acceleration, and notes payable and amounts due guarantor for the years ended December 31 consisted of the following (in thousands):

	<u>1988</u>	<u>1987</u>
Interest charged to operating expense	\$242,867	\$242,334
Other debt expense	7,989	3,833
Total interest and other debt expense	<u>250,856</u>	<u>246,167</u>
Interest on excess coal notes	10,293	10,508
Nuclear fuel	2,855	3,465
Construction-in-progress	326	326
Total interest deferred or capitalized	<u>13,148</u>	<u>14,299</u>
Total interest incurred	<u>\$264,004</u>	<u>\$260,466</u>

Substantially all of the Cooperative's assets are pledged to secure federally guaranteed long-term debt subject to acceleration and long-term debt subject to acceleration as well as other amounts owed the REA as guarantor by means of the Supplemental Mortgage and Security Agreement dated February 24, 1988 (the "REA Mortgage") between the Cooperative, the REA and the JBC. Certain office facilities in Baton Rouge are separately pledged to secure Industrial Development Revenue Bonds.

The JBC is secured by the REA Mortgage for approximately \$34.6 million and \$45.5 million as of December 31, 1988 and 1987, respectively, and for certain letters of credit supporting potential indemnity payments under a sale-leaseback transaction completed in 1983 amounting to approximately \$75.3 million. During 1988, the JBC renewed the letters of credit for an additional five-year period. The JBC also asserts a certain secured interest in stock and patronage capital arising from the Cooperative's borrowing relationships with the JBC. During 1988, the JBC failed to remit approximately \$6 million in revolving patronage capital claiming a right of setoff and

NOTE F - Continued

placed the funds in an interest bearing account controlled by the JBC. The JBC asserted that this action was allowed by virtue of its lien on the Cooperative's stock investment and accumulated equities and by the pledge of the Cooperative. The Cooperative informed the JBC that it did not consent to this action and demanded that the JBC promptly remit the funds being withheld. At the time, the Cooperative was not in arrears to the JBC. Later, as a response to the JBC's action, the Cooperative did not remit approximately \$3.6 million to the JBC for regularly scheduled principal and interest due in October 1988 on its non-guaranteed debt. The JBC applied \$3.6 million of the funds being withheld in satisfaction of the October debt service obligation. At December 31, 1988, the JBC still held approximately \$2.4 million in funds due the Cooperative (see Note Q).

NOTE G - NOTES PAYABLE AND AMOUNTS DUE GUARANTOR

Notes payable and amounts due guarantor at December 31, 1988 consisted of the following (in thousands):

	<u>1988</u>
REA promissory demand mortgage note	\$ 43,175
Other amounts payable to the REA as guarantor	87,310
Citibank, N.A. demand note	<u>182,042</u>
	<u>\$312,527</u>

Interest rates on the demand notes and other amounts due to the guarantor ranged from 6% to 12.5% at December 31, 1988.

On February 25, 1988, as a condition precedent to the completion of the FFB refinancing, the Cooperative was required by the REA to execute a promissory demand mortgage note for approximately \$43.2 million related to payments made by the REA on behalf of the Cooperative to the FFB (see Note F). Other amounts payable to the REA as guarantor at December 31, 1988 represent interest which the REA paid as guarantor to other lenders on behalf of the Cooperative.

Citibank, N.A. in 1984, provided letters of credit for each of the four pollution control revenue bond issues of the Cooperative. On May 10, 1988, Citibank, N.A. sent default and acceleration notices to the respective bond trustees. By May 16, 1988, all four bond issues were called and redeemed at par by the respective bond trustees. The bond trustees utilized bond reserve funds and requisitioned approximately \$200 million against the four letters of credit to pay all principal, interest, and certain fees with respect to the bonds. Draws on the Citibank, N.A. letters of credit are evidenced as unsecured demand notes with an interest rate at prime rate plus two percentage

NOTE G - Continued

points. In accordance with the terms and conditions of the letters of credit and reimbursement agreements, Citibank, N.A. demanded payment of the notes by the Cooperative and, with respect to one of the notes, the Cooperative, in turn, requisitioned funds from the FFB set-asides to pay the demand note. The REA denied the request for funds on the basis that the Cooperative had failed to make all payments when due on outstanding loans made or guaranteed by the REA.

Citibank, N.A. brought suit in 1988 against the Cooperative and the trustees for the pollution control revenue bonds seeking rights to certain bond reserve funds. In November 1988, the United States District Court for the Southern District of New York awarded Citibank, N.A. \$18.1 million which was being held by the bond trustees at that time and the Cooperative reduced the outstanding balance of the Citibank, N.A. demand notes accordingly. As a consequence of the redemption at par of the pollution control revenue bonds, approximately \$5.6 million of unamortized bond issuance costs were expensed by the Cooperative in 1988 (see Note Q).

NOTE H - SHORT-TERM INVESTMENTS

At December 31, 1988, the Cooperative's cash and short-term investments were substantially invested in short-term instruments issued by CFC. All investments conform with the guidelines established by the REA and the Cooperative's Board of Directors. Maturities are selected to correspond with cash flow requirements and are generally for periods of less than two months.

NOTE I - INCOME TAXES

During 1983, less than 85% of the income of the Cooperative was collected from Members for the sole purpose of meeting losses and expenses. As a result, pursuant to Section 501(c)(12)(A) of the Internal Revenue Code of 1986 as amended, the Cooperative became a taxable entity. The Cooperative has received a private letter ruling from the Internal Revenue Service (IRS) stating that once taxable, the Cooperative shall remain taxable until an application is submitted and approved for the redetermination of its taxable status. The Cooperative has made an election under the Internal Revenue Code to remain a taxable entity through the year 2003 in order to participate in certain equipment leases.

The Cooperative had no current or deferred income tax provisions for the years ended December 31, 1988 and 1987.

NOTE 1 - Continued

At December 31, 1988, the Cooperative had general business credit carryforwards of approximately \$166 million of which approximately \$9 million expire in 1999; \$27 million in 2000; \$128 million in 2001; and \$2 million in 2002. As a consequence of the Tax Reform Act of 1986, the investment tax credit portion of the general business credit carryforwards were reduced by 17.5% for 1987 and were further reduced by an additional 17.5% to \$166 million for years subsequent to 1987.

In addition, the Cooperative has loss carryforwards of approximately \$2 billion which may be used to offset future taxable income. The expiration dates and amounts of the net operating loss portion of the total loss carryforwards are as follows (in thousands):

2000	\$ 4,000
2001	203,000
2002	295,000
2003	171,000
2004	303,000
	<u>\$976,000</u>

The remaining losses of approximately \$1 billion are attributable to Member activities and may be carried forward indefinitely.

The Cooperative has available approximately \$817 million in net operating loss carryforwards for alternative minimum tax purposes. The expiration dates and amounts of these loss carryforwards are as follows (in thousands):

2000	\$ 4,000
2001	203,000
2002	295,000
2003	96,000
2004	219,000
	<u>\$817,000</u>

Also, the Cooperative has approximately \$852 million of losses attributable to Member activities for alternative minimum tax purposes which may be carried forward indefinitely. Additionally, approximately \$166 million of the general business credit carryforwards of the Cooperative may be used to offset future alternative minimum tax. These credits expire in the same manner as general business credit carryforwards for regular tax purposes.

NOTE I - Continued

In December 1987, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 96, Accounting for Income Taxes. Management is in the process of analyzing this Statement and its potential impact upon the Cooperative. SFAS No. 96 must be adopted before 1991 and the extent of its impact has not yet been determined.

NOTE J - EMPLOYEE BENEFIT PLAN

Substantially all of the Cooperative's employees participate in the National Rural Electric Cooperative Association (NRECA) Retirement and Security Program. The Cooperative typically makes annual contributions to the plan equal to the amounts accrued for pension expense. In this master multiple-employer plan, which is available to all member cooperatives of the NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. The Cooperative's pension expense under the plan for 1987 was \$422,000. As a result of a better than anticipated return from the plan's investments, the Cooperative was not required to make any 1988 contributions to the plan.

NOTE K - RELATED PARTY TRANSACTIONS

In December 1986, the Cooperative purchased certain substation equipment owned by eight of its Member cooperatives. The purpose of the transaction was to better define the operating responsibilities of the transmission system. The aggregate purchase price of \$12.4 million was partially financed by the Cooperative assuming long-term notes payable to the REA in the amount of \$8.4 million. In addition, the Cooperative agreed to make future payments to certain Members and to the REA for the benefit of these Members totalling \$4 million over 25 years. Final REA action on certain of these transactions is still pending as of December 31, 1988.

NOTE L - SPENT NUCLEAR FUEL AND DECOMMISSIONING COSTS

GSU has executed a contract with the Department of Energy (DOE) whereby the DOE will furnish disposal service for the spent nuclear fuel from River Bend. Currently, the cost amounts to 0.1 cents per kilowatt hour of net generation. The Cooperative, as a joint owner of River Bend, shares this cost with GSU. The DOE spent nuclear fuel fee is subject to change in accordance with the provisions of the Nuclear Waste Policy Act of 1982.

NOTE L - Continued

The Nuclear Regulatory Commission in 1985 proposed an amendment to its regulations which sets forth the technical and financial criteria for decommissioning licensed nuclear facilities. The rule addressed decommissioning alternatives, timing, financial assurance and environmental review requirements. The rule requires electric utilities either to certify that a minimum dollar amount will be available to decommission the facility or to submit a decommissioning funding plan. In addition, the final rule, which was issued in 1988, requires that financial assurance be provided by either prepayment, an external sinking fund, or by a surety, insurance, or other form of guarantee. On December 2, 1988, the Cooperative established an external grantor trust, the River Bend Decommissioning Trust Fund, and is accruing an amount currently estimated to be sufficient to pay for its share of the cost of decommissioning at the end of the estimated useful life of River Bend. The initial funding of the decommissioning trust totalled \$3.7 million. Annual contributions to the trust based on current estimates and assumptions are approximately \$1.4 million.

NOTE M - NUCLEAR INSURANCE

The joint ownership of River Bend subjects the Cooperative to certain risks. The Cooperative is insured, as described below, for public liability and property damage.

The Price-Anderson Act (the Act) was renewed by Congress in 1988 and was extended through August 1, 2002. Public liability under the Act for any nuclear incident is currently limited to \$7.7 billion. The Cooperative and GSU are insured for this exposure by private insurance as well as by a secondary financial program. Recent legislative changes to the Act related to the secondary financial program may require the Cooperative to become subject to a possible retroactive assessment of which the Cooperative's share would not exceed \$19.8 million per incident with a maximum of \$3 million per incident payable in any one year for losses at any licensed nuclear facility.

The Cooperative, together with GSU, maintains \$500 million of property damage insurance and \$400 million of excess insurance related to River Bend obtained from the private insurance market. Additionally, the Cooperative is a member-insured of the Nuclear Electric Insurance Limited (NEIL II) program which provides \$825 million of excess property insurance. As a member-insured of NEIL II, the Cooperative is subject to a maximum assessment of \$2.3 million in any one policy year. Although the Cooperative and GSU continue to attempt to increase the limits of coverage as capacity becomes available, the Cooperative can give no assurance as to the adequacy of its share of such limits in the event of a major accident. Total available property

NOTE M - Continued

damage insurance is substantially less than the potential insurable value of River Bend. The Cooperative has joined GSU in establishing a Nuclear Workers' Liability policy which covers liability for the claims of workers employed at River Bend after January 1, 1988 for non-catastrophic nuclear related injury such as prolonged exposure to low-level radiation. Any claims by workers employed at River Bend prior to January 1, 1988 will continue to be covered under the Nuclear Energy Liability policy if the claim is made by December 31, 1997. Under the Nuclear Workers' Liability policy, the Cooperative is subject to a maximum potential retrospective premium assessment of \$960,000.

It is possible that liabilities related to the release or escape of a hazardous substance from River Bend may be greater than the coverage limitations on policies currently carried and existing insurance may not be sufficient to meet all possible liabilities or losses. The Cooperative cannot provide assurance that it will be able to maintain coverage at present levels. Any liability or loss in excess of that covered under existing policies could have a material adverse effect upon the Cooperative.

NOTE N - EXTRAORDINARY ITEM

In December 1988, the FASB issued SFAS No. 101, Regulated Enterprises - Accounting for the Discontinuation of Application of FASB Statement No. 71. SFAS No. 71 allows regulated entities to account for the effects of regulation by capitalizing or deferring certain costs which enterprises in general would be required to expense under GAAP. In order to apply the provisions of SFAS No. 71, a regulated entity must meet certain criteria, one of which requires the recovery of incurred costs of service through rates. SFAS No. 101 specifies the accounting required when an entity determines that SFAS No. 71 no longer applies to all or a portion of its operations.

In December 1988, the Cooperative determined that SFAS No. 71 no longer applied to its operations inasmuch as it was no longer reasonable to assume that rates could be set at levels and charged to customers which would recover the Cooperative's cost, including interest and other debt expense, of providing service. Accordingly, the Cooperative adopted SFAS No. 101 effective December 31, 1988, which required the write-off of all regulatory assets and liabilities that were capitalized or deferred in accordance with SFAS No. 71.

The SFAS No. 101 write-off of \$320.8 million included deferred charges of \$175.3 million principally related to the cost of stockpiled fuel inventory and the charges associated with the amendment of a coal supply contract; \$63 million of net costs of an abandoned lignite project; \$8.7

NOTE N - Continued

million related to certain work orders; \$65.4 million associated with period costs capitalized during the partial commercialization of the coal units Big Cajun II, Units 1 and 2; \$8.6 million in deferred interest and depreciation on facilities common to all three coal units of the Big Cajun II facility; \$13.2 million in miscellaneous deferred charges and a \$13.4 million reduction in accumulated depreciation associated with the previously capitalized period costs of Big Cajun II, Units 1 and 2. The tax effects associated with the discontinuation of SFAS No. 71 are immaterial.

During 1988, the Cooperative did not expense approximately \$38 million related to excess coal and other costs pursuant to SFAS No. 71. These amounts were included in the SFAS No. 101 write-off of deferred charges as of December 31, 1988, and are included in the amounts in the preceding paragraph.

NOTE O - GULF STATES UTILITIES COMPANY

In August 1979, the Cooperative and GSU entered into a contractual agreement for the joint ownership of River Bend (see Note C). Construction has been completed and the unit was declared to be in commercial operation as of June 16, 1986. The Cooperative has a 30% undivided interest in River Bend and is responsible for 30% of River Bend's costs of construction, capital additions and operations. GSU is the operator of the facility.

In November 1980, the Cooperative and GSU entered into a contractual agreement for the joint ownership of Big Cajun II, Unit 3, a 540 net megawatt coal-fired generating unit, and certain common facilities at Big Cajun II (see Note C). The Cooperative retained a 58% undivided ownership interest in Unit 3 and an 86% undivided ownership interest in the common facilities. The Cooperative is the operator of the Big Cajun II facilities.

In August 1979, the Cooperative and GSU entered into a Sell-back Agreement related to River Bend. On September 2, 1986, the Cooperative and GSU amended the Sell-back Agreement such that, retroactive to June 16, 1986, GSU would purchase, regardless of availability, 70% of the Cooperative's share of the output of River Bend for the first twelve months, 56% during the second twelve months, 42% during the third twelve months, 28% during the fourth twelve months and approximately 19% during the fifth twelve months. The Cooperative recorded revenues of approximately \$117 million in 1988, \$126 million in 1987 and \$109 million in 1986, and expects to receive approximately \$171 million over the remaining two and one-half year term of the amended Sell-back Agreement (see Note A).

NOTE O - Continued

On December 9, 1988, the Cooperative and GSU entered into a Cost of Funds Agreement (the Agreement) which resolved several areas in dispute relating to the Sell-back Agreement. In general, the Agreement sets forth the methodology for determining charges under the provisions of the Sell-back Agreement for the period June 16, 1988 through June 15, 1991. Specifically, the Agreement established fixed charge rates and capacity charge amounts for the period June 16, 1986 through June 15, 1988. Additionally, GSU's return on common equity was fixed at 14.50% for purposes of calculating the capacity charge for the period June 16, 1988 through June 15, 1991. GSU and the Cooperative agreed upon a 2.5% annual depreciation rate for River Bend for purposes of calculating the capacity charges for the period June 16, 1986 through June 15, 1991. In order to reflect the results of the Agreement, the Cooperative reduced its 1988 revenues and recorded receivables from GSU by \$33.9 million.

In September 1988, the Cooperative informed GSU that it intended to exercise its option under the River Bend Joint Ownership Participation and Operating Agreement and independently perform a final cost audit of River Bend. The final cost audit is expected to be completed by April 1989. The Cooperative expects the results of this audit to be a matter of extensive negotiations. The Cooperative expects to make a decision on possible litigation concerning alleged mismanagement relating to the construction of River Bend or fraud in the inducement to enter into the River Bend agreements following completion of the final cost audit.

NOTE P - RATES AND REGULATION

During 1987 and 1988, rates were set by the Cooperative's Board of Directors and were generally designed in accordance with its not-for-profit character and the provisions of the REA Mortgage as modified by certain agreements. In accordance with State law, any proposed change in rates must be announced in a notice to its Members and be the subject of a public hearing. Following the public hearing, the Board of Directors may, after receiving REA approval, enact a change in rates. Through provisions in loan documents, the REA exercises control and supervision in matters of regulatory accounting, issuance of securities, rates and charges for the sale of electricity, and the operation of facilities.

Prior to December 31, 1987, seven of the Cooperative's thirteen Members had voted in accordance with Louisiana Revised Statute 12:426 to be regulated by the LPSC. In September 1987, the LPSC issued Special Orders 8-87 and 9-87 asserting jurisdiction over the Cooperative and all thirteen of its Members. The Cooperative and its six Members not electing LPSC regulation filed legal actions to clarify the authority of the LPSC.

NOTE P - Continued

On October 31, 1988, the Louisiana Supreme Court reversed a lower court ruling and upheld existing State statutes exempting rural electric cooperatives from LPSC regulation unless the membership voted to be regulated. On December 15, 1988, the Supreme Court granted the LPSC's request for a rehearing. The Cooperative cannot predict the timing or outcome of the rehearing by the Supreme Court.

NOTE Q - SUBSEQUENT EVENTS

CoBank: On January 1, 1989, the JBC joined several other regional Banks for Cooperatives in a merger that created a new National Bank for Cooperatives (CoBank).

Workout/Debt Restructure: Settlement discussions between the Cooperative and its creditors have continued beyond December 31, 1988. On February 2, 1989, the REA presented a counterproposal to the Cooperative on certain key elements of the workout and on March 3, 1989, presented a substantial revision and supporting schedules to its earlier counterproposal. Also, on February 2, 1989, CoBank tendered a counterproposal involving the defeasance of the Cooperative's mortgage debt to CoBank through offset of the Cooperative's investment in CoBank stock and equity. Neither secured creditor has instituted legal action to accelerate the Cooperative's debt or exercise other material rights as provided in the REA Mortgage.

On March 20, 1989, the Cooperative received a renewal of the 3713 Waiver for the period beginning April 1, 1989 and ending on June 30, 1989.

On January 3, 1989, the Cooperative did not remit its regularly scheduled fourth quarter principal payment of \$2,860,726 to CoBank. The Cooperative instead paid CoBank approximately \$341,000 and CoBank utilized all remaining funds being withheld, including interest earnings, to satisfy the remainder of the Cooperative's obligation (see Note F). On March 10, 1989, CoBank remitted approximately \$2.1 million to the Cooperative as patronage capital credits for 1988.

Washington-St. Tammany Electric Cooperative, Inc.: On February 1, 1989, a federal district court judge in New Orleans entered an order removing the contract rejection motion by WST from the jurisdiction of the federal bankruptcy court and placing the matter under the jurisdiction of a federal district court in New Orleans. Hearings on the issue of contract rejection are scheduled for July 10, 1989. On February 28, 1989, the federal district court terminated the exclusivity period of WST thereby allowing others to file proposed plans for the reorganization of WST.

NOTE Q - Continued

Unsecured Demand Notes Litigation: On February 3, 1989, Citibank, N.A. filed suit against the Cooperative in the United States District Court for the Southern District of New York alleging damages of approximately \$206 million, including interest and other charges, as a result of drawings on its letters of credit which occurred during 1988 when the Cooperative's pollution control revenue bonds were called and redeemed. Under the terms of the suit, the alleged damages would be reduced by \$18.1 million which Citibank, N.A. had previously collected from the bond trustees. On February 24, 1989, Citibank, N.A. moved for a summary judgment. The motion for summary judgment is scheduled to be heard on April 21, 1989. The Cooperative's response is to be filed with the court by March 31, 1989. Citibank, N.A. may, if it prevails in this action, attempt to enforce the judgment by attaching the cash accounts of the Cooperative. Such an outcome may require the Cooperative to seek protection from its creditors under Chapter 11 of the Bankruptcy Code. Settlement talks between the Cooperative, Citibank, N.A. and the REA are continuing. The Cooperative cannot predict the outcome of the litigation or the settlement discussions. On March 10, 1989, the REA offered Citibank, N.A. a discounted settlement of all claims in this matter. The Cooperative has not paid any amounts related to the unsecured demand notes since legal counsel has advised that to do so may subject the officers, directors and manager of the Cooperative to personal liability (see Notes A and G).

Abandoned Lignite Projects Litigation: On February 22, 1989, a Federal district court judge set aside the jury verdict of \$25.3 million and ordered a new trial regarding the breach of contract suit against the Cooperative. The judge has stipulated that the new trial will be on issues more limited than the first trial. The Cooperative cannot predict the timing or outcome of the matter.

Arbitration: On February 7, 1989, the American Arbitration Association ruled the Cooperative should be paid \$31.9 million by the Riley Stoker Corporation (Riley) concerning certain construction issues associated with the Big Cajun II, Units 1 and 2 coal-fired generating facility. Conversely, the Cooperative was directed by the arbitrators to pay Riley approximately \$10 million principally for unpaid invoices and retainage. On March 9, 1989, Riley paid the net award of \$21.9 million into the registry of the U.S. District Court for the Middle District of Louisiana. The timing of the actual receipt of the cash by the Cooperative is uncertain.

Environmental Closure Fund: On November 14, 1988, the DEQ extended the deadline for providing assurance to the DEQ that the Cooperative has the ability to fund the work which will be necessary to establish, maintain and refurbish its Big Cajun II fly ash pond areas. The Cooperative is presently analyzing forms of assurance including insurance, letters of credit or

NOTE Q - Continued

trusts. The Cooperative expects to create a trust fund or provide other forms of assurance on or before March 31, 1989 (see Note A).

Amounts Paid by Guarantor: Since December 31, 1988 and through February 28, 1989, the REA, as guarantor of substantially all of the Cooperative's debt, has made additional payments to creditors for scheduled debt service on behalf of the Cooperative of approximately \$33.1 million bringing the total of such payments to \$157.7 million. The Cooperative expects the REA to continue to honor its guarantee (see Notes A, F and G).